

STATE OF MICHIGAN
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Testimony As Prepared
Assistant Attorney General Teresa Bingman on behalf of Attorney General Granholm
Office of Insurance and Financial Services Hearing on Insurance Credit Scoring
Lansing

July 9, 2002

Thank you, Mr. Fitzgerald for allowing me to testify this afternoon. My name is Teresa Bingman, and I am an Assistant Attorney General in the Executive Division of the Michigan Department of Attorney General. I appreciate the opportunity to briefly discuss the devastating impact that the use of credit scores to set insurance premiums has had on Michigan consumers.

Using credit scores to determine home and auto insurance premiums in Michigan is a growing practice. The Attorney General's office finds it problematic for three reasons:

1. There is little or no transparency in the insurance industry. Consumers have no way of knowing which specific factors are being used to determine their insurance premiums. In the case of a "credit score," these numbers may be based on a credit report, but are not identical to those reports. Simply reviewing a credit report will not offer a consumer a clear picture of what factors an insurance company has used to set that score.
2. There is little rational and independently verified correlation between a poor credit rating and a poor driving record.
3. Credit reports are notoriously error-ridden. Using an inaccurate report to determine an insurance premium is unwise and unfair.

Lack of Transparency

The Attorney General's office has examined the rate filings of a number of Michigan insurers in order to better understand the use of credit information in insurance decisions. The first thing that is apparent is that it would be incredibly difficult for a consumer to receive the rate published in the rate filings on file with OFIS. Insurance companies have an extraordinary range of discounts that can apply to almost anybody. Because they cannot deny coverage outright due to our Essential Insurance Act, they already have elaborate mechanisms of discounts designed to charge many different prices to many different consumers. I want to stress that the Attorney General's office supports the use of discounts on factors – such as the presence of air bags, anti-lock brakes, and the use of seatbelts – that are directly related to driving, but we do not support the use of insurance history to determine rates.

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According to your office, the Office of Financial and Insurance Services, 11 of 15 largest companies writing auto insurance policies in Michigan use credit history to determine premiums, along with 8 out of the largest 21 homeowners insurance companies. The Attorney General has evidence that the use of credit scores in the insurance industry is hurting Michigan's consumers.

For instance, these are just a few of the many complaints received in the Attorney General's Office on this issue. All of these complaints have been forwarded to OFIS by our office:

- A 76 year old driver with a 1994 Pontiac saw her premiums jump from \$829 to \$983 based on an item in her credit report. She said she had been a customer of her insurance company – GMAC Insurance – for as long as she could remember. After she contacted ChoicePoint, the credit scoring agency mentioned in her notification, requesting a copy of her consumer report, she received nothing.
- In an instance of home insurance, a family with 20 separate items insured through Allstate were customers of that company for 20 years. All payments were always paid in full and on time. These loyal customers were informed by Allstate that due to information on their credit report – their daughter's delinquent cell phone bill of \$100 from several years ago – they were informed that they did not qualify for a premium discount for good credit. Never mind that their payment history with Allstate was impeccable. Their Allstate agent could do nothing to help them.
- In another complaint we received, a 10-year customer with Farmer's Insurance – with no tickets, accidents or claims against any policies – saw his homeowner's insurance premium more than double. Farmer's Insurance stated in their reply that they created a "risk assessment model" from a "group of pre-selected characteristics derived from information" on the customer's credit report but would not tell the consumer what those characteristics were or what he could do to reduce his premium.

In February, CBS MarketWatch reported that "The practice is now so prevalent that, by the industry's admission, someone with a clean driving record and marred credit may pay more for auto insurance than a driver at fault in an accident in the last year with a solid credit history."¹

The findings of a study by the Florida Insurance Commissioner Taskforce on the Use of Credit Reports in Underwriting Automobile and Homeowner's Insurance - one of the most

¹ http://www.napaausa.org/Features/Credit_Action_files/dubious.htm

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comprehensive and objective studies to date on the practice - concluded, "...the use of credit reports has a negative impact on young people, minorities and people with low incomes."²

A study published by the Federal Reserve Board in 1996 indicated that "about 33 percent of the households living in the zip codes with median family incomes in the lowest range have low [TMS "The Mortgage Score" developed by Equifax] scores, compared with only 17 percent of households living in zip codes with median family incomes in the highest range."³

No Correlation between Credit and Driving

Supporters of the use of credit scoring in the determination of insurance premiums claims contend that it rewards individuals with good credit and stops them from subsidizing the insurance risks posed by those with poor credit. Just who has what the insurance companies would define as "bad credit?" "Good credit" has not yet been defined to us by the insurance industry. Is "good credit" a Fair Isaac and Co. score of 600? 700? If 800 is a perfect score, what's the cutoff? The industry will not tell. But a number of factors can have a detrimental impact on an individual's credit score that could raise premiums.

There are some surprising instances that can adversely affect your insurance credit score and result in higher premiums – at least according to the FICO models used by many companies.

- How about refinancing your home mortgage – something many smart consumers are doing these days to take advantage of today's lower interest rates. If you did this in the last 6 months, it counts negatively toward your FICO score. It counts even more negatively if you used a finance company like Ditech.com or The Money Tree.⁴
- Or what about transferring credit card balances from a high-interest card to a new low-interest card? Opening new lines of credit also counts negatively!

² "Task Force on the Use of Credit Reports in Underwriting Automobile and Homeowner's Insurance." Florida Insurance Commission. January 23, 2002. p. 2

³ "Credit Risk, Credit Scoring and Performance of Home Mortgages" Robert Avery, Paul S. Calem and Glenn B. Canner of the Federal Reserve Board's Division of Research and Statistics, Federal Reserve Bulletin; July 1996.

⁴ According to Consumer Reports, simply having a loan from a finance company (as opposed to a bank or a credit union)– even if the loan is paid in full and on time – counts as a "black mark" in the computation of your credit score.

http://www.consumerreports.org/main/detail.jsp?CONTENT%3C%3Ecnt_id=18783&FOLDER%3C%3Efolder_id=18151

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Yet, most people would agree that both of these are examples of *responsible financial behavior*. If the insurance industry's claim that good financial behavior is linked with good driving is true – then these people should be rewarded! Instead, consumers who simply perform normal financial transactions like the ones mentioned above are punished by the flawed model that calculates their supposed riskiness.

That's not all. The models for analyzing credit as used in insurance have the potential to have a disproportionately negative impact on both young people and senior citizens.

- Take, for example, a young person who is just getting her start in the world. Younger folks generally pay higher premiums anyway because they have little driving experience. This makes sense – they are riskier because they are new to driving. But younger people also have not had the chance to establish credit, either. This results in what is commonly known as a “thin file.” People with “thin files” receive unfavorable credit scores. Adding credit scoring as a factor in determining premiums doubly punishes young people because they also do not have an established credit history.
- Here's another example – a senior citizen who has always paid his bills on time, has worked hard to pay off the family's mortgage, yet doesn't use credit cards. If there is no recent activity in a person's credit file, the FICO score will deliver what is called a “no hit.” Some insurance companies – such as Progressive – treat these seniors with “no hits” exactly as they do people with the worst possible credit scores. Never mind that all their bills have been paid on time, or that they are clearly some of the most financially responsible people around. Seniors – those who can least afford it – are being hurt by insurance companies, why? Precisely because they are so financially responsible! This makes no sense – and serves as another example of why credit scores have nothing to do with driving ability for most people.
- Finally, people who have concerns about their privacy are in for a surprise when they try to obtain insurance from many companies here in Michigan. If consumers refuse to give out their social security number because of fears about identity theft – the #1 fraud complaint at the FTC – or simply because they value their privacy – they may be punished with higher premiums by being denied credit-related discounts regardless of their driving history or claims history!

At the extremes, there may be a link between extremely bad credit – for example, multiple bankruptcies and excessive late payments – and an increase in the likelihood of committing

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insurance fraud. But this problem needs to be handled through the normal channels of dealing with criminal fraud. And of course, the Attorney General's office has and will continue to aggressively prosecute insurance fraud cases. But as it is performed today, credit is used to take advantage of **average customers who simply perform normal, responsible financial transactions.**

Credit Reports are Error-Ridden

The *independent* consumer watchdog group, Consumer Reports, has found that 70% of credit reports have some kind of error. And 29% have a major error. These statistics indicate that 70% of the people in this room may be paying an unfair insurance premium because of flawed information on their credit report. Could it be you?

Despite the insurance industry's claims that the use of credit scores is a fair and objective way to determine premiums – it is clear from what we have heard today that the industry's definition of risk based on credit history is **arbitrary** at best. How long must Michigan consumers pay **artificially inflated premiums** while they work to correct inaccuracies on their credit reports?

Currently, There is Little Protection for Consumers

Consumers have been left out in the cold with no protection against any unfair or discriminatory practices imposed by insurance companies because they cannot file suit under Chapter 20 of the Insurance Code. And since the Supreme Court's 1999 decision in ***Smith v. Globe Life Insurance Company***, the Attorney General's office has been precluded from suing insurance companies under the Consumer Protection Act. To add to that, two years later, the legislature took away consumers' rights to bring private actions against insurance companies.

Commissioner Fitzgerald, we urge you to take the lead and ensure that citizens of Michigan are not treated unfairly when insurance premiums are determined. Some insurance companies are using this practice to profit from the supposed credit flaws and even the credit errors attributed to our constituents. It's a deeply flawed correlation and we should not stand for it!

Thank you.

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